Potash Corporation of Saskatchewan

1985 Annual Report

86-03347/

Contents

Crystal Genesis

March, 1986

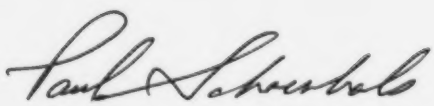
To His Honour,
The Honourable Frederick W. Johnson
Lieutenant Governor of the
Province of Saskatchewan

Sir:

Letter of Transmittal

I have the honour to submit the Annual Report of the Potash Corporation of Saskatchewan for the year ended December 31, 1985, including the financial statements in the form required by the Treasury Board and duly certified in accordance with The Potash Corporation of Saskatchewan Act.

I have the honour to be, Sir,
Your obedient servant



Paul Schoenhals
Minister-in-Charge of the
Potash Corporation of Saskatchewan

Chairman's Message

1985 was a major disappointment for PCS. The Corporation, as the largest producer in Saskatchewan, was hit hard by the collapse of prices throughout the world and by the 20 percent drop in tonnages exported to markets outside North America.

The Corporation's losses mounted at an accelerating rate throughout the year as market conditions continued to deteriorate. These losses will continue until there is a turnaround in the market. The Corporation believes its mines are among the most efficient and productive in the world.

In spite of difficult conditions, and of unfortunate but necessary temporary mine closures during the year, productivity of our employees in all areas of the Corporation remained high. It is our employees upon whom we rely in good or bad economic conditions.

The largest cost component of prices paid by our customers is freight, which continues to escalate and over which the Corporation has little control.

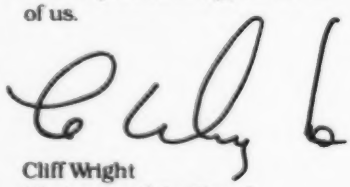
The Board of Directors of the Corporation met eight times in 1985 to provide general direction to the management of the Corporation and to review operations. The Executive Committee of the Board met at various times to review specific pressing matters. Membership of the Board remained constant in 1985.

I would like to mention some highlights of an otherwise gloomy year. Canpotex Limited, the company responsible for marketing all Saskatchewan potash offshore and in which the Corporation is a shareholder, moved its corporate offices to Saskatoon from Toronto. It is a source of personal pride to me that a multinational corporation has chosen Saskatoon as its headquarters.

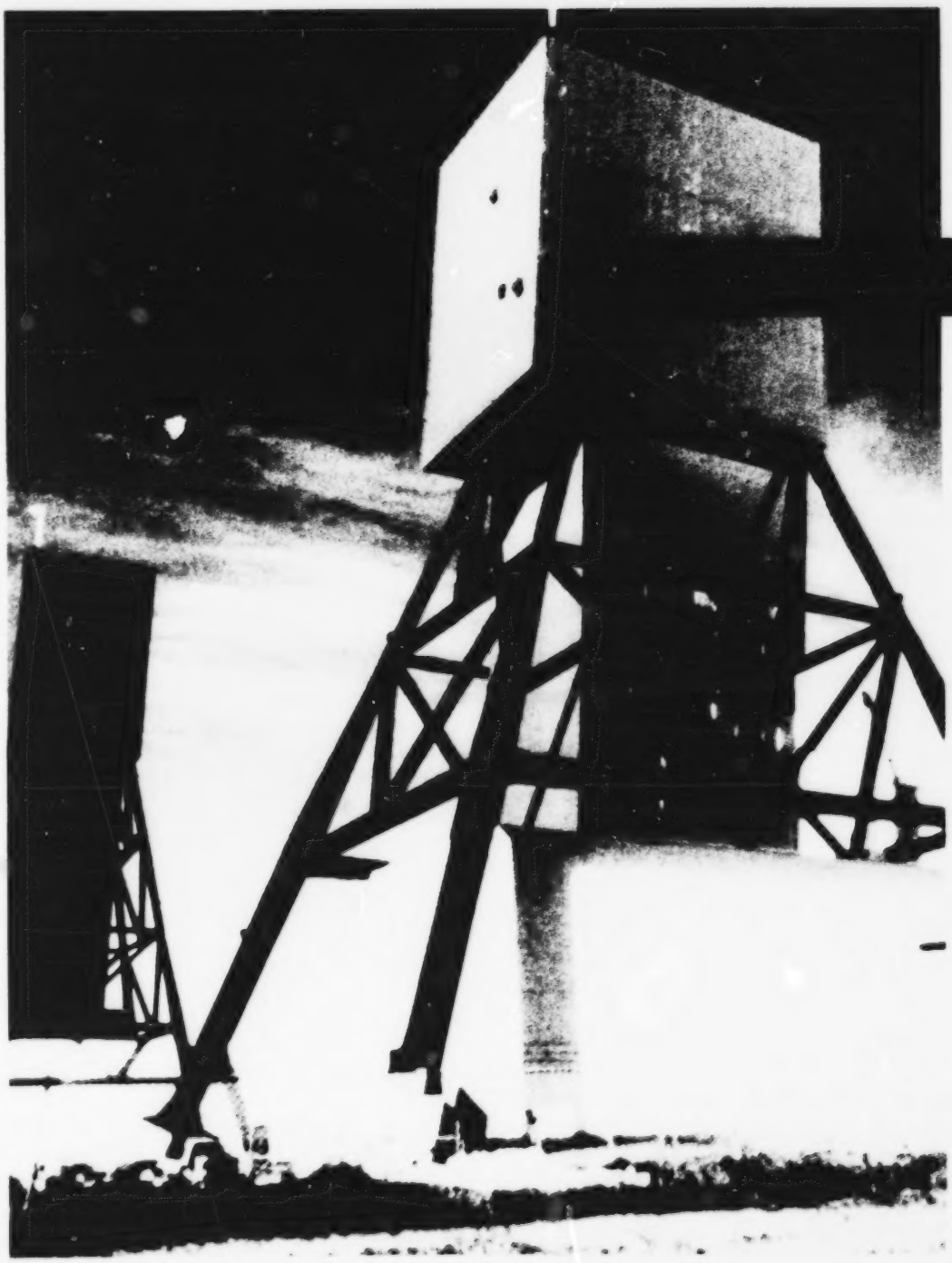
PCS and its subsidiaries also moved their head offices in 1985. The new quarters are more compact and efficient than those occupied previously and a favourable 20 year lease has resulted in cost savings to the Corporation.

The success of the employees of PCS Mining in stemming the brine inflow at Rocanville Division is a fine example of the ability of the Corporation's employees to achieve outstanding results under adverse circumstances. To those employees involved at Rocanville, the Board expresses its gratitude.

On behalf of the Board I would like to thank all of the Corporation's employees, be they sales personnel in the United States, miners in Saskatchewan, or corporate staff, for their dedicated efforts in a very frustrating year for all of us.



Cliff Wright
Chairman of the Board



Headframes

PCS Mining Rocanville Division. The headframes house hoisting apparatus which transports men and equipment underground and transports ore to the surface.

President's Message

The Corporation's net loss in 1985 was $68.7 million compared with a profit of $25.4 million in 1984. Operating losses, before interest expense and provincial taxes, were $6.9 million in 1985 compared with an operating profit of $65 million in 1984. The net loss includes a $19 million extraordinary write down of properties held for future development. We reluctantly concluded that in view of the current economic outlook for potash, these properties are unlikely to be developed in the near future.

In February 1985, when I wrote the President's Message for the 1984 Annual Report, I said, "In 1985, every effort must be made to increase sales volumes, reduce costs and improve profit margins". Based on the actual results for 1985, what went wrong?

In the North American market, which represents 60 percent of our sales, total demand was down by 4 percent or 350,000 tonnes. PCS Sales volumes were 6 percent less than in 1984. In other words our market share dropped, partly as a result of a decision in the early part of the year not to compete for unprofitable business.

After some upward movement in the first quarter, prices declined throughout the year for an overall drop of around 20 percent. That reduction comes straight out of net income. In real terms, prices are now at their lowest levels since 1969.

While prices in the offshore market have not performed as badly as in North America, total volumes sold by all Saskatchewan producers dropped 23 percent compared with 1984. The Corporation's export volumes were 560,000 tonnes less than in 1984. Put in perspective, that is about half the annual production capacity of our Cory Division. The reduction in volume is, in part, due to the virtual absence of the Chinese in the marketplace in 1985. In 1984, Canpotex Limited sold 690,000 tonnes to China.

Aggregate costs have dropped significantly. This is partly a result of the temporary shutdowns of all divisions during the year and partly due to cost saving measures and productivity improvements in all areas. Needless to say, low operating rates have played havoc with unit costs and our targets were not realized. Our cost reduction programme will be continued in 1986.

This combination of reduced volumes, plunging prices, and rising unit costs had a devastating effect on margins and resulted in large losses.

The outlook for the Corporation in 1986 is not encouraging. We are seriously concerned about the state of the potash markets both in North America and overseas. We believe that the huge supply and demand imbalance existing in our industry could keep prices depressed for the next five years. This oversupply, to which our Lanigan expansion will be a contributor in 1986, was brought about by optimistic forecasts in the 1980 period. The growth in demand foreseen at that time has not occurred. As a result, producers worldwide are fighting to maintain market share in a stagnant and, in some cases, declining market.

Computer Technology

Computer facilities, at PCS Head Office in Saskatoon, are the centre of a network embracing PCS Mining, mine locations, PCS Sales Chicago office and the majority of potash storage locations in Canada and the U.S.

PCS continues to encourage increased potash consumption as a means to ultimately rationalize its productive capacity. Through Canpotex Limited and the Potash & Phosphate Institute, we support the extensive educational programs that are carried out in all markets. However, in 1985, our production units ran at approximately 60 percent of capacity. This was a result, in part inadvertent, of the brine inflow at Rocanville Division, and of running Allan, Cory and Lanigan divisions at 75 percent capacity and, lastly, of two month extraordinary closures of all divisions.

Production shutdowns will also be required in 1986 based on current sales projections and the fact that the Lanigan expansion is now essentially complete. This half billion dollar, 2 million tonne project was conceived in the heady days of 1979. The construction schedule was substantially extended, from the original plan to have it go on line in 1983. This addition will increase the Corporation's capacity by 35 percent. This plant should become our lowest cost operation.

In other developments, production of sulphate of potash from the Cory demonstration plant commenced during the year. A pilot plant to produce sulphate of potash using brines from Quill Lake was constructed. Sulphate of potash is a premium specialty fertilizer with potential for industrial applications. These ventures are an attempt to reduce the Corporation's dependence on the potassium chloride market.

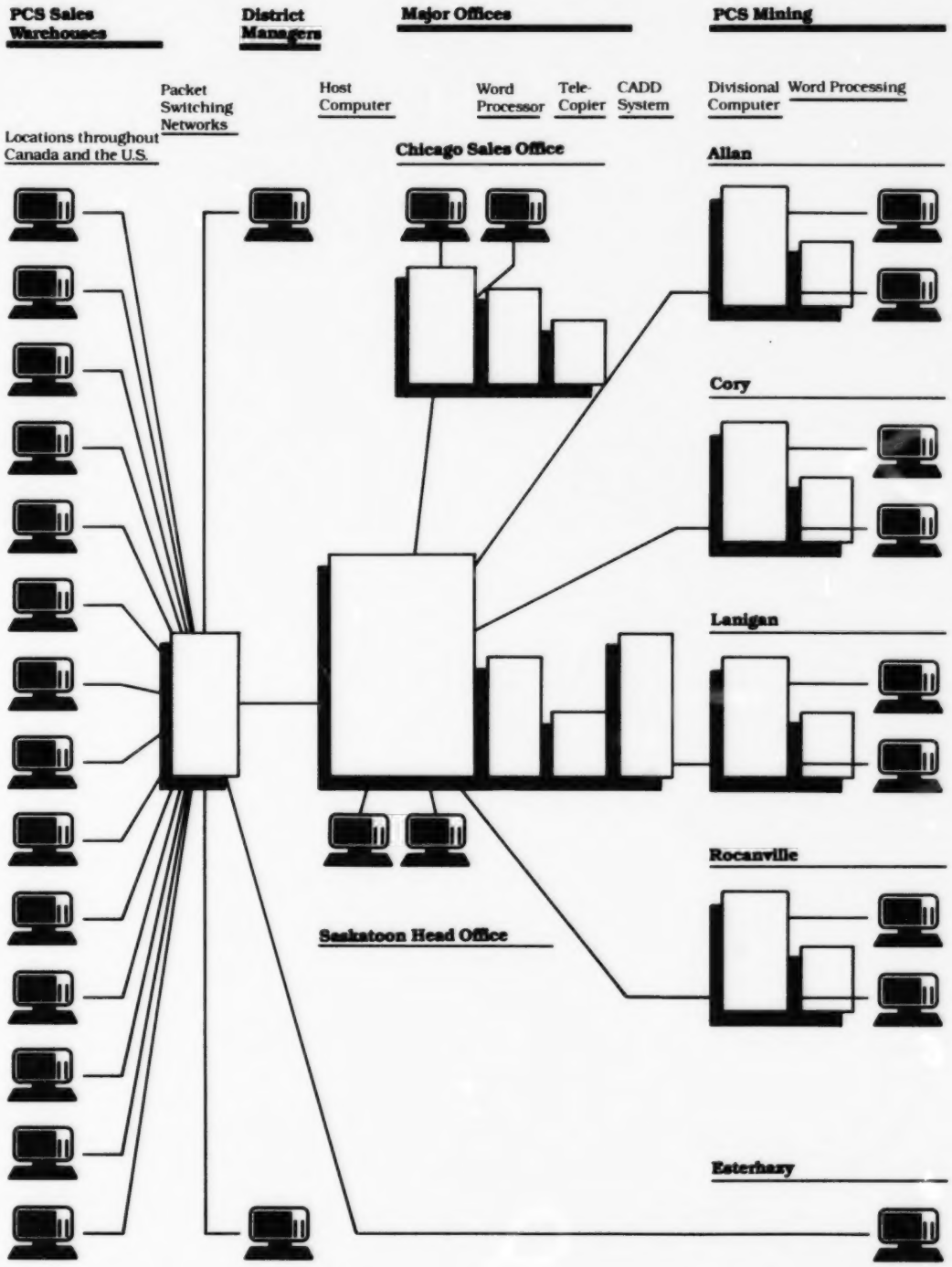
In June of the past year the Corporation and subsidiary head offices moved to a new location in Saskatoon. All head office employees are now under one roof at considerable cost saving both in terms of rent and efficiency. Our computer facilities in these offices are the centre of a network embracing the Saskatchewan mines, PCS Sales Chicago Office and the majority of our storage locations in Canada and the U.S.

Turning to the financial position of the Corporation: although the Corporation had a net loss, cash generated from operations amounted to $20 million. Apart from operating costs, the largest component of expense was interest of $32 million. In addition to the interest charged to expense, a further $37 million was charged to capital in respect of the Lanigan expansion. We expect that in 1986 all interest will be charged to expense.

In 1985 the Corporation required net cash of $112 million. This was financed through the short term market at lower interest rates than could be obtained on the long term market. By year end, the Corporation had 101 cents of debt for every dollar of equity. The interest cost on these borrowed funds, largely incurred to pay for the Lanigan expansion, will continue to seriously impair the Corporation's profitability.

Most of this message conveys a bleak picture of 1985 and not much but gloom for 1986. That is the reality. We must face the facts. Confronted with adversity, it is often easy to lose sight of the positive things in life. Bear in mind, PCS controls the largest potash supply capability in the western world. We ship more product into the North American market than anyone else. We have some of the best mines in the world. Most importantly, we have a well trained group of employees, a large and loyal customer base and a very able and responsive group of suppliers. I thank them all for their support.

Steve W. Harapiak
President & Chief Executive Officer



Computer Network

Improved data communications are playing a role in PCS' efforts to improve efficiency in its operations. A network of computers, leased lines, and public packet switching facilities allows for the timely collection and distribution of information. Marketing, order processing, shipping, production control and financial control all use the network in their daily operations.

PCS Mining

During 1985, the five operating divisions of PCS Mining produced a total of 3.2 million tonnes of product, a reduction of 1.3 million tonnes from the 1984 level. Operating efficiencies held the unit cost increase to less than 4 percent over last year. All divisions with the exception of Esterhazy were closed for an additional five week period during the summer. This down time allowed for reduction and correction of product inventories.

The very serious underground brine inflow which occurred in November 1984 at the Rocanville Division was contained and successfully plugged. The mine returned to production in early March.

On December 30, 1985, a major brine inflow was discovered in the K-2 mine of International Minerals and Chemical Corporation (Canada) Ltd., where product is produced for PCS Mining from our ore reserves. Steps are underway to stem the flow. The K-1 operation continues production but gives PCS Mining about half of normal output.

During the year, the company's prime insurers cancelled the bulk of our underground insurance coverage. Efforts continue to replace coverage of approximately $250 million, but in the meantime any loss underground in excess of $44 million will be at the company's expense.

At the Face

Environmental testing, at the face of the brine inflow, was carried out during the inflow crisis at PCS Mining, Rocanville Division. Control of the major brine inflow was successfully accomplished utilizing a high pressure, poured in place, concrete plug.

The Loss Control System, introduced in 1984 at all PCS Mining Divisions, was in full operation during the year. An audit by the International Loss Control Institute of Atlanta, Georgia rated all our divisions at two stars out of a possible five. This was a considerable achievement after only one year. Serious personal accidents, lost time and medical aid were reduced by 15 percent.

All union collective bargaining agreements expired in 1985. Negotiations continued throughout the year, but no agreements were reached.

PCS Mining employed 1611 persons at year end. This is 173 less than 1984 due to reversion to three shifts at Lanigan, revised organizations at the other Divisions and a drop of 24 percent at the Saskatoon Head office.

Allan Division
Allan Divison's total production for 1985 was 0.712 million tonnes on a three shift operation. Of this total, 0.388 million tonnes were PCS Mining's share and the remainder that of Kidd Creek Mining Ltd., our 40 percent co-tenant. The division employed 400 people.

A major project was initiated to relocate the underground shops and warehouse facilities in the B-Zone mining level 25 feet below the regular A-Zone production level. This is intended to improve the long range stability of the openings for these facilities.

Cory Division
Production at our Cory Division for the year was reduced to 0.563 million tonnes from the 1984 level of 0.743 million tonnes. The division employed 329 people at year end on a three shift operation. Of this total, 19 were employed in the Sulphate of Potash Demonstration Plant (SOP), which was in the startup phase. The SOP plant was close to design level production at year end.

In the fall, all underground mining operations were moved to the north half of the mine to increase operational efficiency. The south part of the mine is being maintained in a standby mode.

Lanigan Division
Due to reduced production requirements, Lanigan Division reverted to three shift operation at mid-year. Production for the year was 0.618 million tonnes as compared to 0.867 million tonnes in 1984. Development work for Phase II Expansion underground was reduced by mid-year and, as well, project forces were reduced.

Operations personnel levels at year-end were: production — 333, Phase II — 40.

Startup of the Phase II Expansion began during the year. By year-end the Loadout Facility, including the storage and reclaim sections, were in operation, and the compaction area was operable. The addition of two compactors with associated crushers, screens and structure was approved for completion in spring 1986.

Lanigan Division is now producing, virtually exclusively, the potash product known as Granular 210, which has a good market acceptance in North America.

Rocanville Division
Production for 1985 at the Rocanville Division was 0.903 million tonnes as compared to 1.358 million tonnes in 1984.

Personnel at year-end numbered 400. The division remained on a four shift operation.

Control of the major brine inflow was accomplished utilizing a high pressure poured-in-place, concrete plug. The interface between the concrete and the potash was re-sealed with chemical grout in the fall. Pressures measured on three pipelines through the concrete plug seemed to be stabilizing, at year-end, somewhat below formation pressure.

The Dry Stacking Project, developed to reduce the environmental hazards of brine contained in the salt tailings, was commissioned in mid year. The project is expected to pile salt tailings in a relatively dry state utilizing 3 large stacking machines and re-circulating the majority of the brine to the refinery.

Esterhazy Division
Production for the year at the Esterhazy Divison was 0.774 million tonnes compared to 0.965 million tonnes in 1984.

Product is mined and refined from PCS Mining ore reserves by International Minerals and Chemical Corporation (Canada) Limited under a long term processing agreement.

The Esterhazy Division is staffed by 3 personnel handling order processing, shipments and maintenance of product inventory.

Research and Development
Long range and operational support Research and Development continued at a somewhat reduced level, with strong support extended to the Diversification group.

In the Process section, work continued on electrostatic separation, compaction, floatation, quality control testing, crystallization and process control instrumentation.

The Mining section did work on optimum mineral extraction, ore cutting technology, energy conservation, mining machine automation, fire resistant hydraulic fluids and rock mechanics.

Environmental research was carried out on noise emissions, in-plant dust emissions and stack emissions. Work was carried out on salt tailings pile stability, brine injection technology, tails pile hydrology, impact of dust on the environment and tails pile decommissioning.

Product Diversification

Commissioning of the Sulphate of Potash Demonstration Plant at PCS Mining, Cory Division, began during 1985. Sulphate of potash is a premium specialty fertilizer.

PCS Sales

1985 was a disappointing year for PCS Sales. The volume of overall industry sales fell by 7.5 percent, primarily due to the sharp drop in offshore sales by Canpotex Limited, the marketing company for Saskatchewan potash producers.

More significantly, revenue deteriorated dramatically. The major reduction in earnings occurred in shipments to North American destinations.

At year end, the outlook remained clouded with respect to both prices and volumes. The prospects for recovery in the potash industry are overshadowed by the weak agricultural situation in North America and by a rise in the productive capacity of mines in Canada and overseas.

North American Markets

PCS Sales' ultimate customer, the farmer, and agriculture in general, have completed a year of dubious achievements. American farmers had one of the most successful harvests in history. In 1985, U.S. farmers harvested 8.6 billion bushels of corn, 12 percent more than 1984 and 4 percent higher than the previous highest yield in 1982. This has resulted in increased carryover stocks which in turn results in an acreage reduction program in 1986.

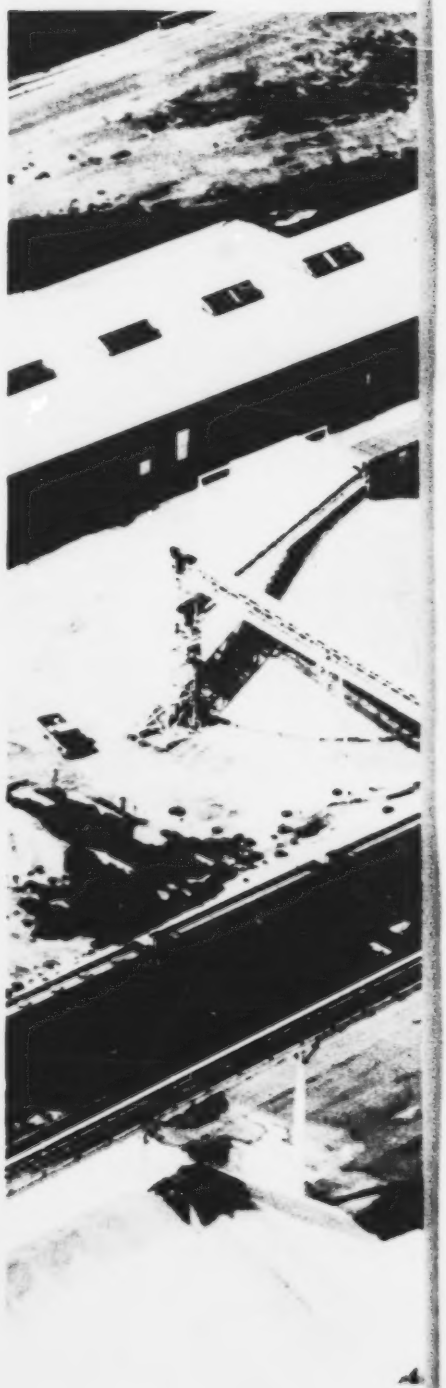
The excess productive capacity of the agricultural sector has created major and agonizing shifts in our industry. North American agriculture is in the midst of those shifts, and this is a very uncomfortable time for industries whose success is tied to agriculture.

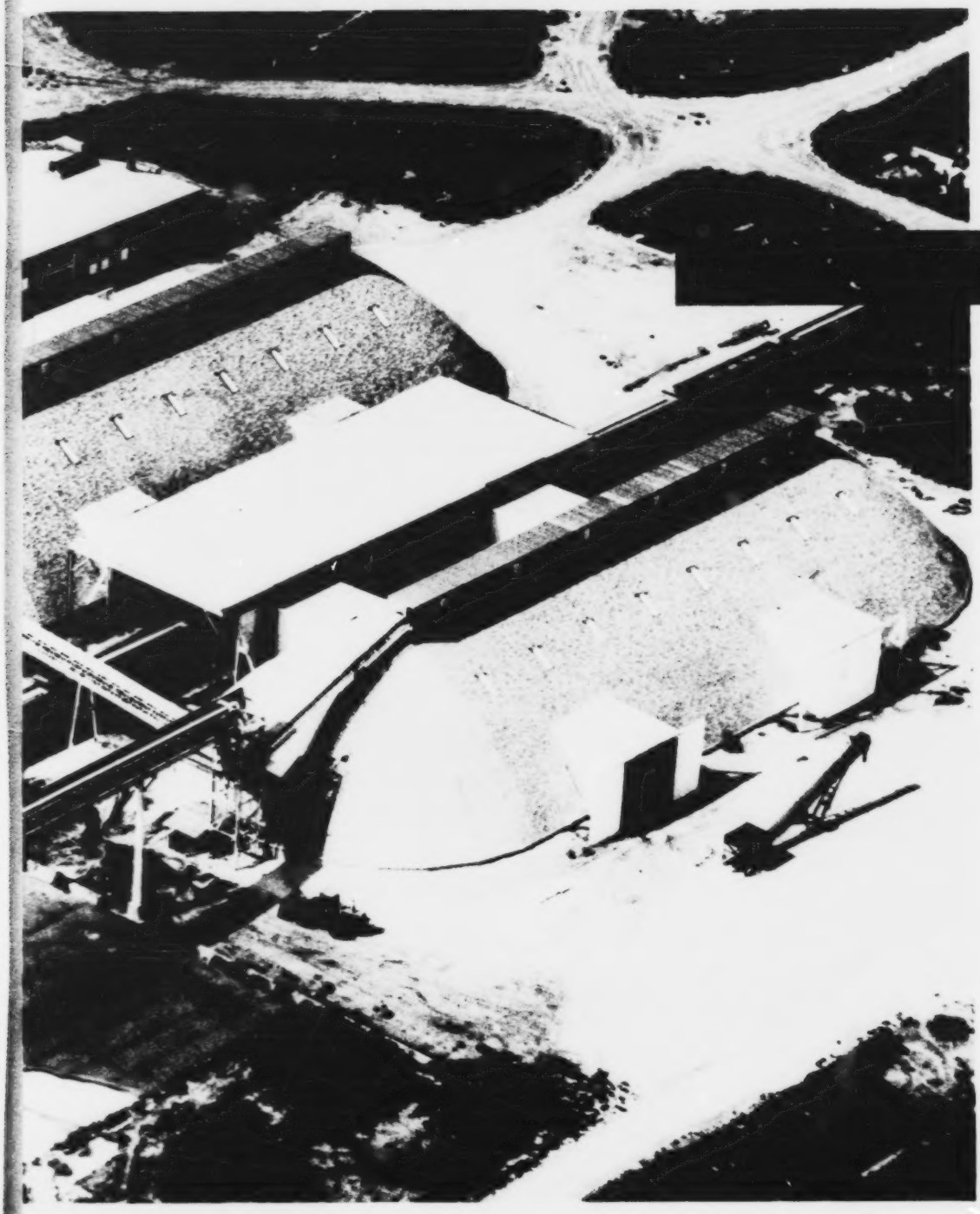
Farm debt in the U.S. has grown from the $180 billion level in the early 1980s to in excess of $212 billion in 1985. The collateral for that debt has fallen more than 20 percent since early 1980s. In effect, as many as 40 percent of the midwest farmers may be sliding towards insolvency as a result of the decapitalization of their asset base. The inability of farmers to repay their debts is jeopardizing the entire rural banking/financial credit system and the old agri-business structure.

On the other side of the coin, U.S. government subsidies to farmers have kept American farm commodity prices artificially high in the export market. In addition, the strong U.S. dollar has made them even more expensive in world markets. Overall, these factors may have contributed to a 16 – 20 percent drop in U.S. farm export products.

Unfortunately the agricultural situation in Canada resembles closely that of our American neighbour.

Because of the continuing depressed financial state of U.S. agriculture, potash sales by North American producers to domestic destinations were off by 4 percent.





Potash Centers

Seneca Potash Center, Seneca, Illinois, has storage capacity of 40,000 tons for distribution to PCS Sales' U.S. customers.

PCS Sales supplied 2.1 million tonnes compared to 2.2 million in 1984. Our sales were slightly lower within Canada and to Florida where the hard freeze last January affected the citrus crop. In addition, wet fall weather in the major growing area of the U.S. midwest delayed harvests which in turn contributed to a drop of 13 percent in fall potash sales overall.

In anticipation of ongoing strong shipments to the international markets, potash production remained at relatively high levels during the first half of the year. These inventories in turn contributed to a rapid softening in prices which continued to slide, reaching levels not experienced in our industry since 1978.

The weak price situation was aggravated by other factors including strong competition among dealers and suppliers, uncertain farm programs, tight money, and low crop prices. Although the fertilizer and potash prices represent good value for money, the farmer and dealer does not appear ready to take advantage of early buying.

During the year, the U.S. dollar retreated 15—20 percent against major currencies from the peak experienced early in 1985. While it would appear that the dollar may have reached a realistic level vis-a-vis the Japanese yen, it is also expected that some further adjustments may yet take place against key European currencies.

The Canadian dollar, on the other hand, continued to weaken throughout the year. At this time, it is difficult to forecast at what level it may stabilize against the U.S. currency. The shift in currency exchange rates will increase the competitiveness of the American and Canadian farmer internationally, although the effect against currencies of major overseas buyers is less certain.

Offshore Market

Saskatchewan sales of potash offshore were 2.9 million tonnes in 1985. PCS Sales supplied 1.3 million tonnes or 43.9 percent.

This level of sales was significantly down from the 1984 record of 4.2 million tonnes. The major reason for this reduction is lack of purchases in 1985 by the People's Republic of China.

The worldwide oversupply of potash contributed to a lowering of prices in offshore markets during the year. Along with lower prices, an increase in request for countertrade was noted. While countertrade may become a growing institutional instrument of trade, its impact on transaction costs will have a deteriorating effect on netbacks in an environment of weak prices.

The outlook for 1986 is for some improvement in overseas sales volumes over 1985 in an increasingly competitive market.

Operations

At December 1985, PCS Sales staff totalled 92 of whom 65 are located at the corporate head office in Saskatoon. During the year we continued to strengthen the U.S. based sales group to allow for more frequent contact with customers and faster response times.

In addition to the Chicago based staff, PCS Sales staff operate wholly-owned warehouses at Fort Dodge, Iowa and Burns Harbor, Indiana. PCS Sales also maintains ownership of a warehouse at Vancouver and along with other Canpotex members, holds an equity position in Neptune Bulk Terminals in Vancouver, a shipper-owned terminal handling potash and other bulk materials.

During 1985, PCS Sales' warehouse network was expanded through both long and short term positions in important market areas. The transportation system required to serve these facilities remains a key element in effectively marketing product. Trainload operations were strengthened and made more flexible to increase the efficiency of all-rail and rail/water systems.

Significant achievements were made in improving the efficiency of order processing at warehouses through the use of computers. On-line terminals were installed at all major warehouses to accommodate increased volume of transactions.

The Agronomy Department has built on its strength by adding a staff person based in the United States. Being closer to customers and to U.S. research projects allows agronomic information to be disseminated more quickly and permits better management of this scarce resource. Close cooperation with the Potash and Phosphate Institute continues on these and other agronomic matters. The maximum economic yield programs assume particular importance to farmers in these difficult times.

Agronomic research plays an important role in PCS Sales. Dr. R.D. Munson of the Potash Phosphate Institute works closely with PCS Sales Agronomists on agronomic matters affecting PCS Sales' customers.

Five Year Review

All figures are expressed in thousands unless otherwise specified

	1985	1984	1983	1982	1981
Production — KCl Tonnes					
Allan Division	388	569	373	478	731
Cory Division	563	743	599	542	911
Esterhazy Division	774	965	718	715	905
Rocanville Division	903	1,358	837	822	992
Lanigan Division	618	867	529	309	832
Total PCS Mining	3,246	4,502	3,106	2,866	4,371
Total Canadian Producers	10,882*	12,703*	9,719*	8,538	11,762
Sales — KCL Tonnes					
North America	2,073	2,204	2,193	1,481	2,115
Offshore	1,291	1,849	1,399	1,168	1,765
Total PCS Sales	3,364	4,053	3,592	2,649	3,880
Total Canadian Producers	10,630*	11,494*	10,795*	8,256	10,388
Financial ($'s)					
Gross Revenue	197,311	227,797	217,702	192,127	391,748
Income before Taxes and Interest	(6,880)	65,044	9,116	21,701	216,160
Provincial Taxes	10,773	17,692	10,822	15,020	70,770
Interest Expense	31,986	22,003	16,301	6,074	3,669
Net Income (Loss) before extraordinary items	(49,639)	25,349	(18,007)	607	141,721
Dividends declared	———	12,000	62,000	50,000	50,000
Gross Payroll & Benefits	60,668	67,071	59,780	64,660	62,620
Capital Expenditures including capitalized interest (net)	95,375	113,931	111,638	140,454	194,756
Cash Flow from Operations	20,048	57,160	99,910	13,926	140,942
Working Capital	(107,274)	33,868	(41,248)	(26,854)	9,897
Long Term Obligations	446,970	455,464	372,980	221,787	88,025
Shareholder's Equity	609,289	678,022	602,673	682,680	732,073
Return on Equity-Pretax	(6.04%)	6.72%	(0.08%)	2.21%	30.96%
-After tax	(7.71%)	3.96%	(2.80%)	0.09%	20.65%
Employees at year end (actual numbers)	1,756	1,917	1,826	2,191	2,267

*Includes producers in New Brunswick

1985 Quarterly Results	**Q1**	**Q2**	**Q3**	**Q4**
Sales — KCl Tonnes	923	838	785	818
Production — KCl Tonnes	971	874	392	1,009
Gross Revenue	60,795	55,572	45,416	35,528
Net Income (Loss) before extraordinary item	(2,194)	(746)	(18,082)	(28,617)
Cash Fow from Operations	(2,679)	31,151	(356)	(8,068)

Management is responsible to the Board of Directors for the preparation of the consolidated financial statements of the Corporation and its subsidiaries. The statements have been prepared in accordance with generally accepted accounting principles applied on a consistent basis. The financial data included elsewhere in this report is consistent with the financial statements and with the underlying information from which these financial statements were prepared.

Management has the primary responsibility for the integrity and objectivity of the financial statements. To fulfill this responsibility, the Corporation maintains appropriate systems of internal control, and policies and procedures to provide reasonable assurance that assets are safeguarded, and that the books and records reflect properly authorized transactions of the Corporation.

The Corporation's independent auditors, Deloitte Haskins and Sells, have been appointed to express an opinion as to whether these financial statements present fairly the Corporation's financial position and operating results in accordance with generally accepted accounting principles consistently applied. Their report is included below.

The Board of Directors has reviewed and approved these financial statements. To assist the Board in meeting its responsibility, it has appointed an audit committee which is composed entirely of outside directors. The committee meets periodically with management, the internal auditors and the independent auditors to review internal accounting controls, audit results and accounting principles and practices.

W. F. AVERY
Vice-President, Finance and Administration

Auditors' Report

To the Members of the
Legislative Assembly of
the Province of Saskatchewan

We have examined the consolidated statement of financial position of Potash Corporation of Saskatchewan as at December 31, 1985 and the consolidated statements of income and retained earnings and of changes in cash flow for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Deloitte Haskins & Sells.

Chartered Accountants

January 31, 1986
Saskatoon, Saskatchewan

Consolidated Statement of Financial Position

as at December 31

	(Thousands) 1985	1984
Assets		
Current Assets		
Accounts receivable	$ 67,844	$ 70,899
Inventories (Note 2)	51,950	62,188
Deposits & prepayments	20,121	17,147
	139,915	150,234
Fixed Assets (Note 3)	1,130,684	1,059,195
Deferred charges and investments (Note 4)	32,849	40,423
	$1,303,448	$1,249,852
Liabilities		
Current Liabilities		
Short Term Debt		
Banks	$ 110,145	$ 26,266
Province of Saskatchewan	50,000	—
Accounts payable and accrued charges	65,750	69,238
Current portion of long term debt	5,699	5,661
Current obligations under capital leases	3,595	3,201
Dividend payable	12,000	12,000
	247,189	116,366
Long term debt (Note 5)	339,205	344,423
Obligations under capital leases (Note 6)	107,765	111,041
	694,159	571,830
Equity		
Province of Saskatchewan investment (Note 7)	480,554	480,554
Retained earnings	128,735	197,468
	609,289	678,022
	$1,303,448	$1,249,852

Consolidated Statement of Income and Retained Earnings

For the Years Ended December 31

	(Thousands) 1985	1984
Income		
Sales	$195,418	$272,353
Interest and other	1,893	5,444
	197,311	277,797
Costs and expenses		
Operating costs other than those shown below	135,091	134,499
Depreciation and amortization	32,713	40,663
Research and development	4,698	3,220
Selling, distribution and administrative	31,689	34,371
	204,191	212,753
Operating Income (loss)	(6,880)	65,044
Interest expense (Note 8)	31,986	22,003
Income (loss) before taxes and extraordinary item	(38,866)	43,041
Provincial taxes (Note 9)	10,773	17,692
Income (loss) before extraordinary item	(49,639)	25,349
Extraordinary item (Note 10)	19,094	—
Net income (loss)	(68,733)	25,349
Retained earnings—beginning of year	197,468	184,119
	128,735	209,468
Dividends	—	12,000
Retained earnings—end of year	$128,735	$197,468

Consolidated Cash Flow Statement

For the Years Ended December 31

	(Thousands) 1985	1984
Operating Activities		
Operating income (loss)	$ (6,880)	$ 65,044
Provincial taxes	(10,773)	(17,692)
Non-cash items — depreciation and amortization	30,438	48,219
(Increase)/decrease in non-cash working capital	7,263	(38,411)
Total cash inflow from operations	20,048	57,160
Financial Activities		
Interest — charged to expense	31,986	22,003
— charged to capital	36,715	35,947
Total interest	68,701	57,950
Long term obligations — incurred	(320)	(78,439)
— repaid	22,496	31,589
Provincial equity investment	—	(62,000)
Dividends paid	—	62,000
Net cash outflow from financial activities	90,877	11,100
Investing Activities		
Additions to — fixed assets — sustaining	11,203	16,291
— fixed assets — plant construction	47,457	61,693
— deferred charges	4,390	3,530
Net cash outflow from investment activities	63,050	81,514
Increase in short term debt	133,879	35,454
Short term debt — beginning of year	26,266	(9,188)
Short term debt — end of year	$ 160,145	$ 26,266

Notes to Consolidated Financial Statements

Note 1

Significant Accounting Policies

The Corporation's accounting policies are in accordance with generally accepted accounting principles. The following policies are considered to be significant:

Principles of consolidation

The consolidated financial statements include the accounts of the Corporation and the wholly owned subsidiaries:

- Potash Corporation of Saskatchewan Sales Limited (PCS Sales)
  - PCS Sales (Iowa) Inc.
  - PCS Sales (Indiana) Inc.
- Potash Corporation of Saskatchewan Mining Limited (PCS Mining)
- Potash Corporation of Saskatchewan Transport Limited (PCS Transport)

PCS Transport has 64% interest in Canpotex Bulk Terminals Limited which is accounted for by the equity method.

Inventories

Inventories of product and raw ore are valued at the lower of average cost or net realizable value. Inventories of materials and supplies are valued at the lower of average cost or replacement cost.

Fixed Assets

Fixed assets are carried at cost. Costs of additions, betterments and renewals are capitalized.

Maintenance and repair expenditures which do not improve or extend productive life are expensed as incurred. Interest associated with major capital projects is capitalized during the construction period at the Corporation's average cost of long term debt, and is included in the total cost of the project.

Depreciation and amortization

Depreciation and amortization are provided on a basis and at rates calculated to amortize the cost of the fixed assets over their estimated useful lives, as set out below:

	Depreciation or Amortization Basis	Approximate Rate
Head Office		
Furniture, equipment and leasehold improvements	Straight-line	10%
Automotive equipment	Straight-line	20%
Mines		
All mine assets	Units of production	
Offsite Storage Facilities		
Buildings, roads and sites	Straight-line	4%
Equipment	Straight-line	8%

Research and development costs

Research costs are charged to expense as incurred.

Development costs are capitalized until a project is determined not to be technically or economically feasible and no future benefit to the Corporation exists, at which time the costs are expensed.

Deferred Charges

Issue costs of long term obligations are amortized over the term of the related liability.

Other development costs which are capitalized are amortized over the estimated useful life of the project to which they relate.

Foreign exchange translation

Sales revenues are translated to Canadian dollars at the average exchange rate for each month, or the applicable forward exchange contract rate. Other operating transactions are translated to Canadian dollars at the average exchange rate for each month.

Monetary assets and liabilities are translated at year-end exchange rates.

Non-monetary assets are translated at the exchange rate prevailing at the time of the transaction.

Long-term liabilities are translated on the basis of year-end exchange rates. Unrealized exchange gains and losses relating to this translation are deferred and amortized over the remaining life of the liability.

Leases

Leases entered into are classified as either capital or operating leases. Leases that transfer substantially all of the

benefits and risks of ownership of property to the Corporation are accounted for as capital leases. At the time a capital lease is entered into, an asset is recorded together with the related long term obligation. Equipment acquired under capital leases is being depreciated on the same basis as other fixed assets. Gains or losses resulting from sale-leaseback transactions are deducted from the cost of equipment under capital lease and amortized on the same basis as the related asset. Rental payments under operating leases are charged to expense as incurred.

Note 2
Inventories

	(Thousands) 1985	1984
Product	$ 28,251	$ 38,117
Raw ore	2,709	3,223
Materials and supplies	20,990	20,848
	$ 51,950	$ 62,188

Note 3
Fixed Assets

	(Thousands) 1985	1984
Land	$ 17,032	$ 17,325
Buildings and improvements	178,569	156,425
Machinery and equipment	627,977	606,654
Plant under construction	349,281	294,799
Deferred exploration and development costs	71,551	69,917
Equipment under capital lease	108,032	107,560
	1,352,442	1,252,680
Less: Accumulated depreciation and amortization	221,758	193,485
	$1,130,684	$1,059,195

Note 4
Deferred Charges and Investment

	(Thousands) 1985	1984
Deferred charges — net		
Issue costs — long term obligations	$ 3,768	$ 4,561
System development and other	373	495
Preproduction costs	2,723	2,017
Research studies	2,372	600
Bredenbury development	—	15,045
Rocanville brine leak costs	—	2,719
	9,236	25,437
Unrealized foreign exchange losses	22,648	14,021
	31,884	39,458
Investment, at equity	965	965
	$ 32,849	$ 40,423

Note 5
Long-Term Debt

	(Thousands) 1985	1984
Province of Saskatchewan		
- Matures on March 15, 1989 with interest at 16% per annum, payable annually (US $75,000)	$104,813	$ 99,105
- Matures on August 15, 1992 with interest at 15% per annum, payable annually (US $50,000)	69,875	66,070
- Matures on March 15, 1990 with interest at 10.75% per annum, payable annually (US $50,000)	69,875	66,070
- Matures December 21, 1988 with interest at 10.75% per annum, payable semi-annually	80,000	80,000
Saskatchewan Heritage Fund		
- Matures in two equal annual instalments on June 30, 1986 and 1987 with interest at 9.3% per annum, payable semi-annually	$10,000	$15,000
- Prepaid in 1985 with interest at 13% per annum	—	13,400
Webster County, Iowa		
- Matures December 1, 1996 with interest at 13% per annum, payable semi-annually (US $3,900)	5,450	5,153
City of Portage, Indiana		
- Matures in seven equal annual instalments on March 1, 1986 to 1992 inclusive with interest at 12.25% per annum, payable quarterly secured by assets of PCS Sales (Indiana) Inc. (US $3,500)	4,891	5,286
	344,904	350,084
Less amounts due within one year	5,699	5,661
	$339,205	$344,423

Principal payments due on long-term debt for the next five years are as follows:

(thousands)				
	1986 - $	5,699	1988 - $	80,699
	1987 - $	5,699	1989 - $	105,512
			1990 - $	70,574

Note 6
Lease Commitments

The Corporation has long term lease agreements, the longest of which expires in 2005. Future minimum lease payments under these capital and operating leases will be approximately as follows:

	(Thousands)	
	Operating	**Capital**
Years ending December 31		
1986	$ 13,474	$ 16,859
1987	10,264	16,859
1988	8,699	16,859
1989	7,584	16,859
1990	3,778	16,859
Subsequent years	19,705	142,725
		227,020
Less — amount representing interest		115,660
Present value of minimum capital lease payments		111,360
Current obligation		3,595
Long term portion		$107,765

Note 7
Province of Saskatchewan Investment

	(Thousands)	
	1985	**1984**
Saskatchewan Heritage Fund	$418,554	$418,554
Crown Investments Corporation of Saskatchewan	62,000	62,000
	$480,554	$480,554

Note 8
Interest Expense

	(thousands)	
	1985	**1984**
Interest on		
- Long-term debt	$ 47,422	$ 46,202
- Short-term debt	7,712	2,889
- Obligations under capital lease	13,567	8,859
	68,701	57,950
Less capitalized interest	36,715	35,947
	$ 31,986	$ 22,003

Note 9
Income Taxes

By virtue of the fact that the Corporation is wholly owned by the Province of Saskatchewan, neither it nor its wholly owned subsidiaries are subject to Federal or Provincial income taxes in Canada. Certain income and assets of its subsidiaries and affiliates are subject to Federal and State taxes in the United States.

Note 10
Extraordinary Item

In view of the current economic outlook for potash, the Bredenbury site is unlikely to be developed in the foreseeable future. Costs incurred in prior years for exploration, mineral rights and feasibility studies at Bredenbury and other locations, and previously included as deferred charges, have been written off.

Note 11
Contractual Obligations and Commitments

The Corporation is expanding its Lanigan division at an estimated cost, including capitalized interest, of $544,000,000 of which approximately $498,000,000 has been expended to date.

PCS Sales is a shareholder in Canpotex Limited, an offshore marketing company. Should any operating losses be incurred by Canpotex Limited, they will be proportionately shared by its shareholders. PCS Sales is also a guarantor of the performance by Canpotex Limited for certain railcar leases.

PCS Sales and PCS Mining have guaranteed a mortgage loan not to exceed $4,300,000 for warehousing facilities in Danville, Illinois.

Note 12

Directors and Officers

The aggregate 1985 remuneration to directors and senior officers amounted to $1,109,000 (1984 - $1,143,000).

Note 13

Related Party Transactions

Included in these consolidated financial statements are expense amounts resulting from routine operating transactions conducted at prevailing market prices with various Saskatchewan Crown controlled departments, agencies and corporations with which the Corporation is related. Account balances resulting from these transactions are included in the Consolidated Statement of Financial Position and are settled on normal trade terms.

Other amounts due to or from related parties and the terms of settlement are described separately in the consolidated financial statements and the notes thereto.

Note 14

Comparative Figures

Certain of the prior year's comparative figures have been reclassified to conform with the current year's presentation.

Board of Directors

(at March 31, 1986)

** **Cliff Wright, Saskatoon**
Chairman of the Board
Mayor, City of Saskatoon

** **Honourable Paul Schoenhals**
Minister of Tourism and Small Business; Supply and Services; Science and Technology; Province of Saskatchewan and Minister in Charge of PCS

* **Josie Black, Regina**
Farmer

* **Al Brissette, Deliale**
Retired

† **William M. Elliott, Q.C., Regina**
Partner
Law Office, MacPherson, Leslie & Tyerman

Donald Flamme, Carievale
Farmer

* **Peter Golf, Saskatoon**
Peter Golf Enterprises

† **Dallas Howe, Saskatoon
President, BDM Systems Ltd.

* **Brent Logan, Calgary**
President, Logan Chev-Olds (1981) Ltd.

Dr. Andy Schmitz, California
Professor, University of California

** **Earl Silcox, Carlyle**
Farmer/Rancher

† **J. Gordon Wicijowski, F.C.A., Regina
Managing Partner, Clarkson Gordon

* Member of Audit Committee
† Member of Compensation Committee
** Member of Executive Committee

Management

(at March 31, 1986)

Steve W. Harapiak
President & Chief Executive Officer

William F. Avery
Vice President, Finance & Administration

Keith E. Barton
Vice President, General Counsel & Secretary

Douglas A. Karvonen
Vice President, Corporate Development

Peter Braun
Director, Internal Audit

Potash Corporation of Saskatchewan Mining Limited

Donald G. Matheson
President

James J. Bubnick
Vice President, Personnel & Industrial Relations

Donald J. Irvine
Vice President, Engineering

Floyd E. Pellan
Director, Group Services

Graeme Strathdee
Director, Research & Development

Garth Moore
General Manager, Rocanville Division

Rick Lacroix
General Manager, Cory Division

Jim Johnstone
General Manager, Allan Division

Rob McCallum
General Manager, Lanigan Division

Potash Corporation of Saskatchewan Sales Limited

Rolf H. Holzkaemper
President

Douglas E. Logsdail
Executive Vice President

N. Gene Jones
Vice President, Sales

Alec S. Kocur
Vice President Finance & Administration

Sid S. Blair
Director, Sales (Canadian & National Accounts)

Jim M. DeLong
Director, Sales (Industrial Products & Product Development)

Jack O. Ellis
Director, Sales (Co-op Accounts & Inventory Management)

Barry R. Jarrett
Director, Sales, U.S. Branch

William G. Irvine
Director, Transportation

Bruce W. Karras
Director, Market Research & Planning

The Head Offices for the Potash Corporation of Saskatchewan, PCS Sales and PCS Mining are located at:

PCS Tower
Suite 500
122 - 1st Avenue South
Saskatoon, Saskatchewan
S7K 7G3
Phone: (306) 933-8500
Wats: (800) 667-3930
Telex: 074-2699
Telecopier: (306) 652-2699

PCS Sales Chicago Office:

Suite 120
3030 Salt Creek Lane
Arlington Heights, Illinois
60005
Phone: (312) 392-2200
Wats: (800) 241-6908
TWX: (910) 221-2912
Telex: 392-3107
Telecopier: (312) 392-2598

PCS Mining Divisions:

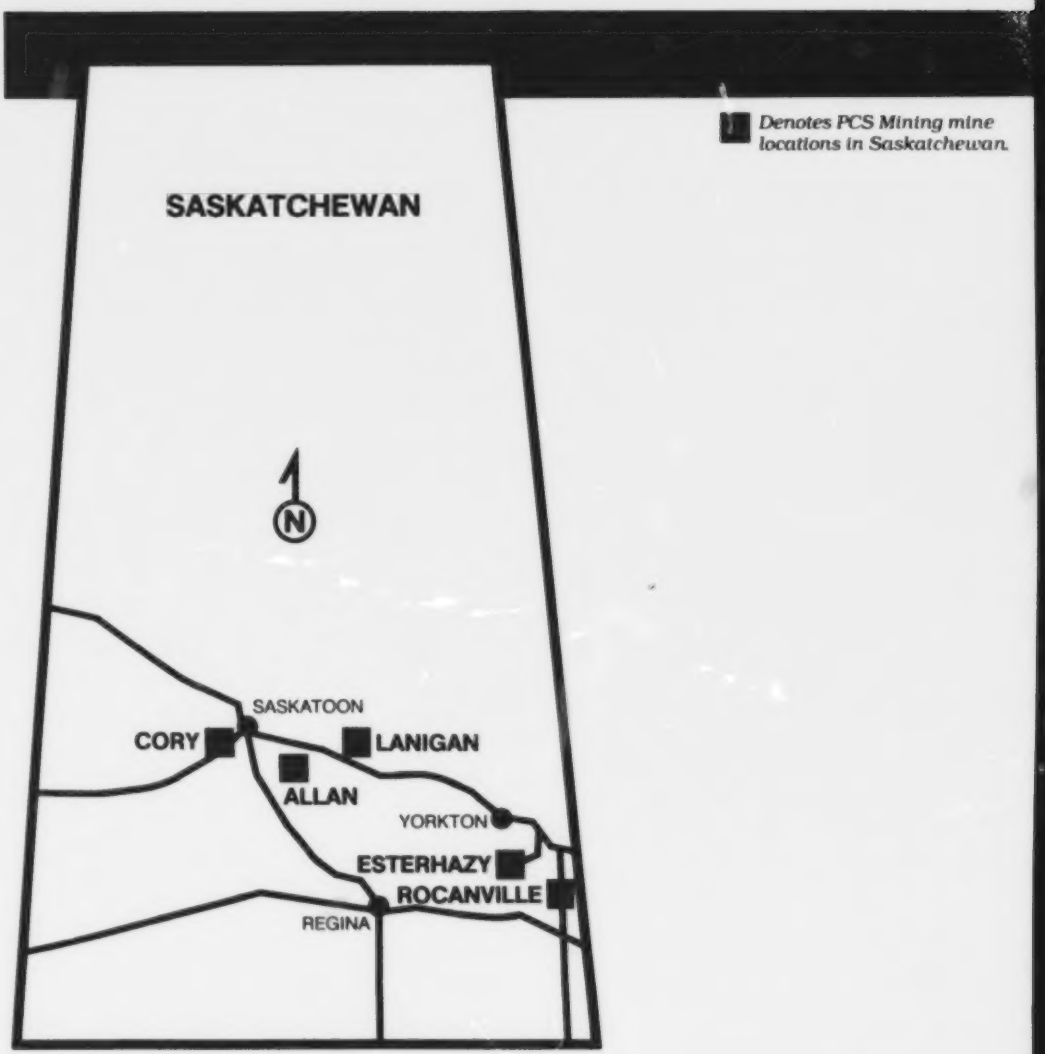
PCS Mining Cory Division
P.O. Box 1320
Saskatoon, Saskatchewan
S7K 2N8
Phone: (306) 382-0525
Telex: 074-2682

PCS Mining Rocanville Division
Rocanville, Saskatchewan
S0A 3L0
Phone: (306) 645-2870
Telex: 971-2342

PCS Mining Esterhazy Division
P.O. Box 1060
Esterhazy, Saskatchewan
S0A 0X0
Phone: (306) 745-6601
Telex: 075-87856

PCS Mining Lanigan Division
P.O. Box 3100
Lanigan, Saskatchewan
S0K 2M0
Phone: (306) 365-2030
Telex: 074-2318

PCS Mining Allan Division
Allan, Saskatchewan
S0K 0C0
Phone: (306) 257-3312
Telex: 074-2634



Denotes PCS Mining mine locations in Saskatchewan.